

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Terra Networks Transaction

In October 1999, IDT entered into a joint venture agreement with Terra Networks, S.A. ("Terra") pursuant to which the two parties formed two limited liability companies to provide Internet services and products to customers in the United States. One company was formed to provide Internet access to customers and the other company was formed to develop and manage an Internet portal that would provide content-based Internet services. IDT's 49% interest in the Internet access company was accounted for using the equity method of accounting. The equity method was used since IDT had significant influence, but less than a controlling voting interest. IDT's 10% interest in the Internet portal company was accounted for at cost. The cost method was used since IDT did not have a controlling voting interest, or an ownership or voting interest so large as to exert significant influence, and the venture was not publicly traded. On April 30, 2000, the Company sold its interests in the two joint ventures for the right to receive 3.75 million shares of Terra common stock. In connection with these sales, the Company recognized a pre-tax gain of \$231.0 million for the year ended July 31, 2000. During the years ended July 31, 2000 and 2001, the Company sold a total of 3.745 million of its Terra shares and recognized therewith a gain of \$24.9 million and a loss of \$129.2 million, respectively, which have been included as a component of "investment and other income (expense)."

3. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	July 31	
	2001	2002
	(in thousands)	
Equipment	\$264,422	\$ 343,874
Computer software	10,192	11,468
Leasehold improvements	21,603	27,453
Furniture and fixtures	11,120	12,242
Land and building	8,937	8,934
	316,274	403,971
Less accumulated depreciation and amortization	(92,232)	(153,340)
Property, plant and equipment, net	<u>\$224,042</u>	<u>\$ 250,631</u>

Fixed assets under capital leases aggregated \$104.2 million and \$118.3 million at July 31, 2001 and 2002, respectively. The accumulated amortization related to these assets under capital leases was \$35.4 million and \$50.2 million at July 31, 2001 and 2002, respectively. Amortization of fixed assets under capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations.

During the year ended July 31, 2002, the Company recorded an impairment charge associated with its property, plant and equipment of \$3.9 million, primarily resulting from the write-down of certain decommissioned European telecommunications switch equipment and certain discontinued wireless-related equipment.

As a result of the Company's gradual exit from the dial-up Internet access service business, including the sale of a majority of its dial-up Internet access customers, the Company recorded an impairment charge associated with its property, plant and equipment of \$ 6.0 million during the year ended July 31, 2001, primarily relating to equipment previously used to provide dial-up Internet access services.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

4. Goodwill, Licenses and Other Intangibles

In June 2001, the FASB issued SFAS No. 142. Under the new rules, goodwill and intangible assets deemed to have indefinite lives would no longer be amortized but rather be subject to impairment tests performed at least annually, in accordance with the Statement. Other intangible assets would continue to be amortized over their useful lives.

The Company chose to early adopt the new rules on accounting for goodwill and other intangible assets and began to apply them beginning in the first quarter of Fiscal 2002. As such, the Company performed the required impairment tests of goodwill as of August 1, 2001, and, as a result, the Company recorded an impairment charge of \$147.0 million, net of income taxes of \$3.5 million. The impairment charge was recorded in the first quarter of Fiscal 2002 as a cumulative effect of a change in accounting principle. In determining the impairment charge, the Company obtained an independent valuation of the underlying assets in which discounted cash flows analyses were utilized. As a result, it was determined that the fair value of certain reporting units were less than their carrying values. The implied fair value of goodwill was then determined to be below its carrying value. As a result, the Company recorded an impairment charge to reduce the fair value of goodwill attributable to these reporting units to its carrying value.

During the year ended July 31, 2002, the Company recorded goodwill of \$4.9 million as a result of acquisitions, primarily in the Company's Media business segment. The table below reconciles the change in the carrying amount of goodwill by operating segment for the period from July 31, 2001 to July 31, 2002:

	Wholesale Telecommunications Services	Retail Telecommunications Services	Winstar	Internet Telephony	Media	Corporate	Total
			(in thousands)				
Balance as of July 31, 2001	\$ 44,148	\$ 104,211	\$—	\$—	\$29,934	\$—	\$178,293
Effect of adoption of SFAS No. 142	(44,148)	(103,635)	—	—	(2,725)	—	(150,508)
Acquisitions during 2002 ...	—	446	—	—	4,471	—	4,917
Balance as of July 31, 2002	<u>\$ —</u>	<u>\$ 1,022</u>	<u>\$—</u>	<u>\$—</u>	<u>\$31,680</u>	<u>\$—</u>	<u>\$ 32,702</u>

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The following table presents the impact of SFAS No. 142 on income (loss) before extraordinary item and cumulative effect of accounting change, net income (loss) and earnings per share had the standard been in effect for the years ended July 31, 2000 and 2001:

	Year Ended July 31,		
	2000	2001	2002
	(in thousands, except per share data)		
Income (loss) before extraordinary item and cumulative effect of accounting change	\$233,826	\$532,359	\$(156,366)
Add back: goodwill amortization	14,926	16,313	—
Adjusted income (loss) before extraordinary item and cumulative effect of accounting change	\$248,752	\$548,672	\$(156,366)
Earnings per share—basic	\$ 3.34	\$ 7.79	\$ (2.08)
Add back: goodwill amortization	0.21	0.24	—
Adjusted earnings per share—basic	\$ 3.55	\$ 8.03	\$ (2.08)
Earnings per share—diluted	\$ 3.11	\$ 7.12	\$ (2.08)
Add back: goodwill amortization	0.20	0.22	—
Adjusted earnings per share—diluted	\$ 3.31	\$ 7.34	\$ (2.08)
Net income (loss)	\$230,850	\$532,359	\$(303,349)
Add back: goodwill amortization	14,926	16,313	—
Adjusted net income (loss)	\$245,776	\$548,672	\$(303,349)
Earnings per share—basic	\$ 3.30	\$ 7.79	\$ (4.04)
Add back: goodwill amortization	0.21	0.24	—
Adjusted earnings per share—basic	\$ 3.51	\$ 8.03	\$ (4.04)
Earnings per share—diluted	\$ 3.07	\$ 7.12	\$ (4.04)
Add back: goodwill amortization	0.20	0.22	—
Adjusted earnings per share—diluted	\$ 3.27	\$ 7.34	\$ (4.04)

The following disclosure presents certain information on the Company's licenses and other intangible assets. All licenses and intangible assets are being amortized over their estimated useful lives, with no estimated residual values.

	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Balance
(in thousands)				
As of July 31, 2002				
Amortized intangible assets:				
Licenses	5 years	\$23,994	\$ (3,175)	\$20,819
Core technology, trademark and patents	5 years	5,295	(611)	4,684
Total		\$29,289	\$ (3,786)	\$25,503
As of July 31, 2001				
Amortized intangible assets:				
Licenses	5 years	\$42,523	\$(23,038)	\$19,485
Core technology, trademark and patents	5 years	2,817	(2,791)	26
Total		\$45,340	\$(25,829)	\$19,511

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Licenses and other intangible assets amortization expense was \$0.9 million, \$4.9 million and \$3.8 million for the years ended July 31, 2000, 2001 and 2002, respectively. The Company estimates that amortization expense of licenses and other intangible assets for each of the next five fiscal years ending July 31 will be approximately \$5.1 million.

5. Related Party Transactions

The Company has entered into a number of agreements with Net2Phone. Pursuant to these agreements, during the years ended July 31, 2001 and 2002, the Company billed Net2Phone approximately \$56.8 million and \$31.6 million, respectively, and Net2Phone billed the Company approximately \$19.2 million and \$16.1 million, respectively. In the year ended July 31, 2000, Net2Phone was included in the Company's consolidated financial statements and any amounts billed were eliminated in consolidation. The net balance owed to the Company by Net2Phone was approximately \$19.3 million and \$0.8 million as of July 31, 2001 and 2002, respectively.

The Company currently leases one of its facilities in Hackensack, New Jersey from a corporation which is wholly owned by the Company's Chairman. Aggregate lease payments under such lease was approximately \$24,000 for the years ended July 31, 2000, 2001 and 2002. The Company made payments for food related expenses to a cafeteria owned and operated by the son of the Company's chairman. Such payments were \$0.1 million and \$0.6 million in fiscal years 2001 and 2002, respectively. No payments were made to the cafeteria in fiscal 2000.

The Company has obtained various insurance policies that have been arranged through a company affiliated with individuals related to both the Chairman and the General Counsel of the Company. The aggregate premiums paid by the Company with respect to such policies was approximately \$0.1 million, \$2.2 million and \$3.6 million for the years ended July 31, 2000, 2001 and 2002, respectively. IDT retained the services of a private insurance consulting firm to ensure that these insurance policies were both necessary and reasonable. The commissions that were earned on such premiums are shared with several insurance wholesalers that access excess and surplus lines of insurance held by the Company.

On December 13, 2001, IDT granted to its Chairman options to purchase 1 million shares of IDT Class B common stock, at an exercise price of \$12.06 per share. The options were to vest over a period of 5 years, at a rate of 50,000 options per quarter, commencing on January 1, 2002. On May 14, 2002, IDT's Chairman waived and agreed to the cancellation of any rights under the options, and, as a result, all the options were cancelled retroactive to their December 13, 2001 date of grant.

The Chief Executive Officer and Vice-Chairman of the Company is a partner in a law firm that has served as counsel to the Company since July 1996. Fees paid to this law firm by the Company amounted to \$0.3 million, \$0.0 million and \$0.5 million for fiscal years ended July 31, 2000, 2001 and 2002 respectively. In addition, a Director of the Company is of counsel to a law firm that has served as counsel to the Company since November 1999. Fees paid to this law firm by the Company amounted to \$1.0 million, \$3.1 million and \$6.3 million for fiscal years ended July 31, 2000, 2001 and 2002, respectively.

In addition, the Company had loans outstanding to officers and employees aggregating approximately \$7.7 million and \$10.3 million as of July 31, 2001 and 2002, respectively, which are included within "other assets" in the accompanying consolidated balance sheets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

All of the Company's related party transactions are reviewed by the Audit Committee of the Company's Board of Directors.

6. Income Taxes

Significant components of the Company's deferred tax assets and deferred tax liabilities consist of the following:

	July 31	
	2001	2002
	(in thousands)	
Deferred tax assets:		
Unrealized losses on securities	\$ 857	\$ —
Bad debt reserve	3,980	10,179
Exercise of stock options	9,857	9,857
Reserves	4,500	4,500
Charitable contributions	10,765	10,795
Net operating loss	—	170,404
Other	8,992	9,899
Deferred tax assets	38,951	215,634
Deferred tax liabilities:		
Deferred revenue	(196,000)	—
Partnership	—	(278,000)
Unrecognized gain on securities	(100,313)	(28,709)
Gain on sales of subsidiary stock	(105,466)	(120,574)
Depreciation	(16,074)	(14,801)
Identifiable intangibles	(3,583)	(7,083)
Other	(8,429)	(8,440)
Deferred tax liabilities	(429,865)	(457,607)
Net deferred tax liabilities	<u><u>\$(390,914)</u></u>	<u><u>\$(241,973)</u></u>

The provision for (benefit from) income taxes consists of the following for the years ended July 31:

	2000	2001	2002
	(in thousands)		
Current:			
Federal	\$ —	\$ 6,600	\$ —
State and local and foreign	(394)	14,249	(30,683)
	<u>(394)</u>	<u>20,849</u>	<u>(30,683)</u>
Deferred:			
Federal	175,191	150,997	(72,788)
State and local and foreign	41,712	37,549	(17,349)
	<u>216,903</u>	<u>188,546</u>	<u>(90,137)</u>
	<u><u>\$216,509</u></u>	<u><u>\$209,395</u></u>	<u><u>\$(120,820)</u></u>

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The income statement classification of the provision for (benefit from) income taxes consists of the following at July 31:

	2000	2001	2002
	(in thousands)		
Provision for (benefit from) income taxes attributable to			
continuing operations	\$218,403	\$209,395	\$(124,345)
Income tax benefit attributable to extraordinary loss	(1,894)	—	—
Income tax benefit attributable to cumulative effect of accounting change	—	—	3,525
	<u>\$216,509</u>	<u>\$209,395</u>	<u>\$(120,820)</u>

The differences between income taxes expected at the U.S. federal statutory income tax rate and income taxes provided are as follows:

	2000	2001	2002
	(in thousands)		
Federal income tax at statutory rate	\$137,513	\$261,618	\$(149,693)
Foreign tax rate differential	—	(99,563)	(53,806)
Losses for which no benefit provided	32,703	19,141	87,602
Nondeductible expenses	17,625	2,162	52,921
State and local and foreign income tax, net of federal benefit	28,612	26,037	(57,844)
Other	56	—	—
	<u>\$216,509</u>	<u>\$209,395</u>	<u>\$(120,820)</u>

7. Stockholders' Equity

Common Stock, Class A Common Stock, and Class B Common Stock

The rights of holders of common stock, Class A common stock and Class B common stock are identical except for certain voting and conversion rights and restrictions on transferability. The holders of Class A common stock are entitled to three votes per share. The holders of Class B common stock are entitled to one-tenth of a vote per share, and the holders of common stock are entitled to one vote per share. Class A common stock is subject to certain limitations on transferability that do not apply to the common stock and Class B common stock. Each share of Class A common stock may be converted into one share of common stock, at any time, at the option of the holder.

Stock Options

Prior to March 15, 1996, the Company had an informal stock option program whereby employees were granted options to purchase shares of common stock. Under this informal program, options to purchase 4,317,540 shares of common stock were granted.

The Company adopted a stock option plan as amended (the "Option Plan") for officers, employees and non-employee directors to purchase up to 6,300,000 shares of the Company's common stock. In May 2000, the Board of Directors of the Company approved an amendment to the Option Plan to reserve for issuance 300,000 shares of Class B common stock. In September 2000, the Board of Directors of the Company approved an amendment to the Option Plan to reserve for issuance of an additional 3,000,000 shares of Class B common stock. On May 31, 2002, the Company distributed a stock dividend of one share of Class B common stock for each share of the Company's common stock, Class A common stock and Class B common stock. Accordingly, pursuant to the terms of the Option Plan, up to an additional 9,600,000 shares of Class B common stock were reserved for issuance under the Option Plan. In October 2001, the Board of Directors of the Company approved an amendment to the Option Plan to reserve for issuance an additional 3,000,000 shares of Class B common stock. In September 2002, the Board of Directors of the Company approved an amendment to the Option Plan to reserve for issuance of an additional 3,000,000 shares of Class B common stock. Generally, options become exercisable over vesting periods up to six years and expire ten years from the date of grant.

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A summary of stock option activity under the Company's stock option plan and stock option program is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding at July 31, 1999	7,175,932	\$ 5.25
Granted	8,851,086	9.98
Exercised	(2,621,400)	5.54
Canceled	(95,000)	8.86
Forfeited	(31,500)	10.93
Outstanding at July 31, 2000	13,279,118	8.31
Granted	5,112,004	9.15
Exercised	(1,041,451)	6.61
Canceled	(299,247)	5.71
Forfeited	(55,200)	12.63
Outstanding at July 31, 2001	16,995,224	8.70
Granted	4,599,982	12.11
Exercised	(6,403,708)	8.42
Canceled	(1,012,376)	11.96
Forfeited	(19,900)	11.99
Outstanding at July 31, 2002	14,159,222	\$ 9.69

The following table summarizes the status of stock options outstanding and exercisable at July 31, 2002:

Range of Exercise Prices	Stock Options Outstanding		
	Number of Options	Weighted-Average Remaining Contractual Life (in years)	Number of Stock Options Exercisable
\$0.10 - \$0.10	290,296	2.0	290,296
\$0.21 - \$0.21	17,632	2.7	17,632
\$0.41 - \$0.41	36,000	2.0	36,000
\$0.83 - \$0.83	30,000	2.7	30,000
\$2.19 - \$2.63	639,500	4.7	639,500
\$3.44 - \$4.13	489,550	4.7	489,550
\$5.63 - \$8.00	5,649,968	8.0	2,016,499
\$8.72 - \$12.13	5,144,618	7.7	2,657,050
\$13.13 - \$18.51	1,861,658	8.4	1,070,358
	<u>14,159,222</u>	<u>7.5</u>	<u>7,246,885</u>

The weighted-average fair value of options granted was \$7.42, \$7.05 and \$9.34 for the years ended July 31, 2000, 2001 and 2002, respectively.

Pro forma information regarding net income (loss) and net income (loss) per share is required by SFAS 123, and has been determined as if the Company had accounted for employees' stock options under the fair value method provided by that statement. The fair value of the stock options was estimated at the date of

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grant using the Black-Scholes option pricing model with the following assumptions for vested and non-vested options:

	<u>2000</u>	<u>2001</u>	<u>2002</u>
Assumptions			
Average risk-free interest rate	6.49%	4.77%	4.22%
Dividend yield	—	—	—
Volatility factor of the expected market price of the Company's common stock	81%	90%	73%
Average life	5 years	5 years	5 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employees' stock options.

For purposes of pro forma disclosures, the estimated fair value of the options under SFAS No. 123 is amortized to expense over the options' vesting period. For the years ended July 31, 2000, 2001 and 2002, pro forma net income (loss) and pro forma net income (loss) per share under SFAS No. 123 amounted to the following:

	<u>2000</u>	<u>2001</u>	<u>2002</u>
	(in thousands, except per share data)		
Net income (loss), as reported	\$230,850	\$532,359	\$(303,349)
Pro forma net income (loss)	\$214,286	\$514,716	\$(328,611)
Net income (loss) per share, as reported:			
Basic	\$ 3.30	\$ 7.79	\$ (4.04)
Diluted	\$ 3.07	\$ 7.12	\$ (4.04)
Pro forma net income (loss) per share:			
Basic	\$ 3.06	\$ 7.54	\$ (4.38)
Diluted	\$ 2.84	\$ 6.88	\$ (4.38)

The Company has modified stock options granted for certain employees of the Company to accelerate or extend their terms. Accordingly, the Company recorded additional compensation expense of approximately \$1.0 million, \$3.1 million and \$1.9 million for the years ended July 31, 2000, 2001 and 2002, respectively. During Fiscal 2002, the Company granted options to certain employees to purchase 14,546 shares of common stock in its subsidiary, IDT Telecom, at an average exercise price of \$366.67 per share. No such options were exercised during the year.

Net2Phone Stock Options

During the quarter ended July 31, 2000, stock options issued to certain officers and employees of Net2Phone were accelerated in accordance with the original stock option awards and as a result Net2Phone recorded \$12.5 million in compensation charges as a result of the acceleration. During the quarter ended July 31, 2000, stock options issued to certain officers and employees of IDT were modified and as a result, Net2Phone recorded \$18.3 million in compensation charges.

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Stock Buyback Program

Our Board of Directors has authorized the repurchase of up to 45 million shares (adjusted for the May 2001 stock dividend) of our common stock and Class B common stock. During Fiscal 2002, we repurchased approximately 1.4 million shares of our common stock, for an aggregate purchase price of \$15.6 million. Combined with the 6.8 million (adjusted) shares and 7.4 million (adjusted) shares repurchased during Fiscal 2001 and Fiscal 2000, respectively, we have repurchased a total of 15.6 million shares under the share repurchase program through the end of Fiscal 2002, of which 6.2 million shares were retired as of July 31, 2002.

Liberty Media Transaction

On March 27, 2000, Liberty Media agreed to purchase approximately 9.9% of the equity of IDT, equal to approximately 3.775 million shares of IDT's common stock and exchangeable for shares of Class B common stock (before adjusting for the May 2001 stock dividend). On June 6, 2000, Liberty Media completed the purchase of 3.729 million shares of IDT's common stock (before adjusting for the May 2001 stock dividend) at \$34.50 per share (before adjusting for the May 2001 stock dividend), resulting in aggregate cash consideration of \$128.6 million. Liberty Media also has the right to nominate a director for election to the IDT Board of Directors.

On October 11, 2001 IDT issued to Liberty Media 3.810 million shares of IDT Class B common stock in exchange for the 3.729 million shares of IDT common stock held by Liberty Media. The exchange rate was based upon the relative average market prices for the IDT Class B common stock and the IDT common stock during a specified 30 trading day period.

Liberty Media Investment in IDT Telecom, Inc.

On January 30, 2002, IDT Telecom sold 7,500 newly issued shares of its common stock to Liberty Media at a price of \$4,000 per share, for total aggregate proceeds of \$30.0 million. As a result of this investment, Liberty Media became the owner of approximately 4.8% of the common equity of IDT Telecom (0.5% of the voting power). The Company owns the remaining common equity of IDT Telecom.

AT&T Transaction

In March 2000, the Company was granted the option to sell to AT&T 4.1 million shares of its Class B common stock for approximately \$74.8 million. In March 2001, the Company exercised this option.

Hicks, Muse, Tate & Furst Transaction

In June 2001, the Company issued stock options to Hicks, Muse, Tate & Furst Incorporated ("HMTF") to purchase up to 2.2 million shares of the Company's Class B common stock at exercise prices ranging from \$11.25 to \$15.00 per share, as defined. The stock options are exercisable on the first anniversary of the agreement, and expire on the fifth anniversary date. In consideration for the stock options issued to HMTF, the Company received \$2.0 million in cash.

IDT Charitable Foundation

In May 2001, the Company established the IDT Charitable Foundation (the "Foundation") with the purpose of obtaining money or property to be contributed from time to time to eligible charitable organizations. The Foundation also administers a matching gifts program available to IDT's directors, officers, employees and retirees.

In July 2001, the Company funded the Foundation with 2.2 million shares of Class B common stock worth approximately \$26.4 million at that time.

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8. Commitments and Contingencies

Legal Proceedings

On January 29, 2001, the Company filed a Complaint with the United States District Court for the District of New Jersey, against Telefonica S.A., Terra Networks, S.A., Terra Networks, U.S.A., Inc. and Lycos, Inc. The complaint asserts claims against the defendants for, among other things, breaches of various contracts, breach of fiduciary duty, securities violations, fraudulent misrepresentation, negligent misrepresentation, fraudulent concealment and tortious interference with prospective economic advantage. The defendants have been served with the Complaint. The Company has filed an Amended complaint and the defendants have filed an answer to the amended complaint. Terra Networks, S.A. has filed a counterclaim for breach of contract alleging that the Company was required to pay to Terra Networks, S.A. \$3.0 million, and failed to do so. The defendants have filed a motion to dismiss the complaint. On September 14, 2001, the Court issued an Order: (a) permitting the Company to take discovery relevant to the subject of whether Telefonica S.A. is subject to personal jurisdiction, (b) denying Telefonica S.A.'s motion to dismiss for lack of personal jurisdiction without prejudice to Telefonica S.A.'s right to renew the motion upon the completion of jurisdictional discovery, and (c) carrying on the calendar defendants' motion to dismiss on non-jurisdictional grounds pending the completion of jurisdictional discovery, which is ongoing. Each party served the other party with certain requests for discovery relevant to the subject of whether Telefonica S.A. is subject to personal jurisdiction. The motions were denied almost in their entirety. The case continues in the early stages of discovery. No trial date has yet been set in this matter.

On May 25, 2001, we filed a statement of claim with the American Arbitration Association naming Telefonica Internacional, S.A. ("Telefonica") as the Respondent. The statement of claim asserts that the Company and Telefonica entered into a Memorandum of Understanding ("MOU") that involved, among other things, the construction and operation of a submarine cable network around South America ("SAm-I"). The Company is claiming, among other things, that Telefonica breached the MOU by: (1) failing to negotiate SAm-I agreements; (2) refusing to comply with the equity provisions of the MOU; (3) refusing to sell capacity and back-haul capacity pursuant to the MOU; and (4) failing to follow through on the joint venture. Telefonica has responded to IDT's Statement of Claim and has filed a Statement of Counterclaim which alleges, among other things: (1) Fraud in the Inducement; (2) Tortious Interference with Prospective Business Relations; (3) Breach of the Obligations of Good Faith and Fair Dealing; and (4) Declaratory and Injunctive Relief. Discovery is in its final stages and both parties have submitted expert reports. The arbitration is ongoing and is expected to continue into 2003.

In September 2001, Alfred West filed a complaint against the Company and its wholly-owned subsidiary, IDT Telecom, Inc. in the Federal District Court in Newark, New Jersey seeking monetary damages of \$25 million for alleged breach of contract, breach of implied covenant of good faith and fair dealing, fraud, negligent misrepresentation, promissory estoppel, quantum meruit, tortious interference and unfair competition. The Company filed counterclaims for fraud, negligent misrepresentation, breach of fiduciary duty, tortious interference and breach of contract. Several depositions have been completed, and discovery should be completed by the end of October 2002.

Winstar acquired certain domestic telecommunications assets formerly owned by Old Winstar, which was approved by the Bankruptcy Court on December 19, 2001 (the "Sale Order"). Although many of the purchased assets were transferred to Winstar at the time of the sale, the transfer of certain of Old Winstar's regulated telecommunications assets, including its customer base, was subject to a number of federal and state regulatory approvals and on Winstar's obtaining the necessary telecommunications facilities and services necessary to serve the customers it agreed to purchase from Old Winstar. Subsequently, Winstar has entered into interconnection agreements with the relevant RBOCs and has sought to use services and facilities obtained pursuant to those

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agreements and pursuant to RBOC tariffs to complete its network and therefore to be able to transition the customers from service by Old Winstar to Winstar.

Although all of the regulatory approvals necessary for this transition have now been issued, the RBOCs have asserted that Winstar is nevertheless not entitled to obtain uninterrupted services under their interconnection agreements and tariffs unless the RBOCs receive payment of approximately \$40 million, in the aggregate, allegedly owed by Old Winstar for access to RBOC facilities and circuits. Based on the claim that Winstar must pay this "cure" amount as a condition of receiving uninterrupted service, the RBOCs have refused in certain instances to provide facilities and service to Winstar that it needs in order to serve its customers directly. As a result, Winstar is operating the business of Old Winstar pursuant to a management agreement approved by the bankruptcy court, and is providing services to the customers on behalf of Old Winstar.

Winstar contends that, even were it to assume the Old Winstar contracts with the RBOCs, the amounts set forth in the RBOC's proofs of claim greatly exceed any reasonable "cure" for facilities and services that Winstar seeks to obtain from the RBOCs, since the claims include significant amounts that Old Winstar owed for services and facilities that IDT Winstar has not requested, and does not need to be able to provide services to the customers following the transition. Winstar also disputes the RBOC's claims that they are not obligated to provide services and facilities to Winstar without an assumption or assignment of the Old Winstar contracts and a payment of "cure" amounts. In response to the RBOC's refusal to provide service, on April 17, 2000 Winstar filed an Emergency Petition for a Declaratory Ruling at the FCC (Inc. Docket No. 02-80) asking that the FCC declare that the refusal of the RBOCs to provide the requested services and facilities pursuant to their interconnection agreements and tariffs, and their refusal to transition such services in a manner that does not interrupt services to the customers is unreasonable and therefore unlawful under federal law. In response, one RBOC (Verizon) filed a counter-petition asking that the FCC declare that the federal telecommunications laws do not require it to provide facilities and services to Winstar without "cure" of Old Winstar's debts. A number of parties filed comments in the FCC proceeding on both sides of the issue and the proceeding is still pending at the FCC. Winstar believes that the RBOCs have acted unreasonably and unlawfully in denying its requests for services and facilities and will continue absent a settlement with the RBOCs to advocate its position vigorously.

In addition, faced with likely termination of service to Old Winstar customers in violation of the Telecommunications Act and number our FCC regulations, we sought injunctive relief (in addition to other remedies) in the U.S. District Court for the District of New Jersey against Verizon, Qwest Corp. and Qwest Communications Corp. ("QCC") to prevent them from discontinuing underlying services which would prevent us from providing service to our customers. Certain interim relief was secured, and Verizon, Qwest and QCC subsequently agreed not to terminate service without appropriate notice to us. The District of New Jersey action is ongoing.

The RBOCs further contend that the provision in the Sale Order requiring them to continue serving Old Winstar and its subsidiaries expired on or about April 18, 2002. Winstar promptly moved to enforce that provision of the Sale Order, but the bankruptcy court denied its motion. Winstar has appealed the denial of that motion to the U.S. District Court for the District of Delaware. In addition, Winstar asked the District Court for interim relief during the pendency of its appeal to stay the RBOCs and other service providers from cutting off service until the appeal is decided. The District Court has not yet ruled on that request, but has temporarily ordered that service providers, including the RBOCs, may not terminate service or otherwise affect Winstar's business without permission of the Court.

During preliminary status hearings before the District Court on May 24 and June 4, 2002, the RBOCs and Winstar advised the Court of their willingness to enter into settlement discussions and/or non-binding mediation

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

in an attempt to resolve their disputes. Those settlement discussions and mediations are ongoing, and the District Court appeal is therefore still pending. It is too soon to predict whether settlements will be reached with any or all of the RBOCs or, if so, to quantify the monetary effect of such settlements, if any, on Winstar. To the extent that a settlement agreement is not reached with any or all of the RBOCs, we expect that the appellate proceedings will resume. One possible outcome of an adverse ruling by the District Court on either the interim relief requested by Winstar or on the merits of the case could be to permit the RBOCs to terminate services that are being provided to our customers and therefore to prevent the uninterrupted transition of those customers to Winstar service. A status conference is scheduled for November 8, 2002, for the parties to report on the progress of their efforts to mediate the disputes.

Winstar believes that the RBOCs have acted unreasonably and unlawfully in denying its request for services and facilities and will continue absent a settlement to advocate its positions vigorously. However, adverse results in one or more of the above-described RBOC litigations could have a material adverse effect on us, including payment of the "core" amount described above, or the inability of Winstar to access the RBOCs services and facilities, in which its business is substantially dependent.

On or about July 25, 2002, PT-1 Communications, Inc. ("PT-1") filed a summons and complaint against the Company and its subsidiaries, IDT Netherlands, B.V., IDT Telecom, Inc. and IDT Domestic Telecom, Inc. (collectively "the Company") in the United States Bankruptcy Court for the Eastern District of New York. PT-1 seeks (a) to recover damages for certain fraudulent transfers of property of the Debtor's bankruptcy estate, (b) to recover damages for unjust enrichment, and (c) to recover damages from breaches under the agreement between the parties for the sale of the Debtor's debit card business to the Company, including the Company's alleged failure to remit payment for use of certain telecommunication and platform services on or through PT-1 switches. In total, PT-1 is seeking \$24 million in damages as well as certain unstated amounts. The Company served its answer on September 18, 2002. Initial discovery will commence shortly.

On or about September 16, 2002, a complaint was filed by Mark B. Aronson in the Court of Common Pleas of Allegheny County, Pennsylvania seeking certification of a class consisting of consumers who were charged a fee when the Company switched underlying carriers from Global Crossing to AT&T. At this point no specific damages have been specified in the complaint. Thus, the Company cannot yet quantify its exposure.

On or about September 19, 2002, a complaint was filed by Ramon Ruiz against the Company and Union Telecard Alliance, LLC in the Supreme Court of the State of New York seeking certification of a class consisting of consumers who allegedly purchased and used the Company's pre-paid calling cards and were charged any fee that was not specifically disclosed on the card packaging prior to purchase. The complaint seeks damages in excess of one hundred million dollars.

On or about October 11, 2002, a complaint was filed by Paul Zedeck against us and Union Telecard in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida, seeking certification of a class consisting of consumers who allegedly purchased and used our prepaid calling cards and were charged any fee that was not specifically disclosed on the card packaging prior to purchase. The damages sought have not yet been quantified. Because we only recently received the complaint, we are still evaluating the potential impact and our approach to contesting the claims or attempts to certify the classes.

On or about October 18, 2002, a complaint was filed by Morris Amsel against us and IDT Telecom in the Supreme Court of the State of New York seeking certification of a class consisting of consumers who allegedly purchased our calling cards. Plaintiff's complaint relates to payphone charges and international rates. The complaint seeks damages of not less than \$100 million. Because we only recently received the complaint, we are still evaluating the potential impact and our approach to contesting the claims or attempts to certify the classes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On or about October 24, 2002, Winstar filed suit against Superior Logistics Management Services, Inc. ("Superior") in the United States District Court for the Eastern District of Virginia. The complaint alleges counts for breach of contract (Superior breached a settlement agreement with Winstar), conversion (for retaining Winstar's property), and detainue (for return of the property). Winstar is seeking approximately \$50 million in damages, plus punitive damages, costs, and attorney's fees.

The Company is subject to other legal proceedings and claims, which have arisen in the ordinary course of its business and have not been finally adjudicated. Although there can be no assurances in this regard, in the opinion of the Company's management, such proceedings, as well as the aforementioned actions, will not have a material adverse effect on results of operations, cash flows or the financial condition of the Company.

Lease Obligations

The future minimum payments for capital and operating leases as of July 31, 2002 are approximately as follows:

	Operating Leases	Capital Leases
	(in thousands)	
Year ending July 31:		
2003	\$ 69,420	\$ 27,110
2004	52,174	23,482
2005	43,961	13,747
2006	39,340	10,808
2007	37,003	1,317
Thereafter	150,991	—
Total payments	<u>\$392,889</u>	76,464
Less amount representing interest		(8,106)
Less current portion		<u>(22,960)</u>
Capital lease obligations—long-term portion		<u>\$ 45,398</u>

Rental expense under operating leases was approximately \$6.9 million, \$4.9 million and \$27.3 million for the years ended July 31, 2000, 2001 and 2002, respectively. The significant increase in rental expense in Fiscal 2002 is due primarily to the significantly higher number of operating leases associated with our Winstar segment, which was acquired in December 2001.

Commitments

The Company has entered into purchase commitments of approximately \$25 million as of July 31, 2002, primarily related to connectivity agreements. In addition, in April 2002, the Company entered into a four-year agreement to grant a telecommunications provider an exclusive right to service the Company's consumer long distance business traffic, in which the Company agreed to purchase a minimum usage over the term of the agreement. In the event that the Company terminates the agreement before the expiration date, the Company is subject to an early termination penalty of \$15 million if cancelled in the first year, \$10 million if canceled in the second year, \$5 million if cancelled in the third year and \$2 million if cancelled in the fourth year.

The Company guarantees payments of certain of its vendors through August 2009. Such guarantees amounted to \$3.4 million as of July 31, 2002. In addition, the Company also provides certain such guarantees to its vendors in the form of letters of credit, through June 2008. Such guarantees amounted to \$8.6 million as of July 31, 2002.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

9. Defined Contribution Plan

The Company maintains a 401(k) Plan (the "Plan") available to all employees meeting certain eligibility criteria. The Plan permits participants to contribute up to 20% of their salary, not to exceed the limits established by the Internal Revenue Code. The Plan provides for a matching contribution up to a maximum of 6% of covered compensation, which vests over five years. All contributions made by participants vest immediately into the participant's account. For the years ended July 31, 2000, 2001 and 2002, Company contributions to the Plan amounted to approximately \$0.3 million, \$0.8 million and \$0.9 million, respectively. The Company's common stock and Class B common stock are not investment options for Plan participants.

10. Business Segment Information

The Company has identified five reportable business segments: Wholesale Telecommunications Services, Retail Telecommunications Services, Winstar, Internet Telephony and Media. The operating results of these business segments are distinguishable and are regularly reviewed by the chief operating decision maker.

The Wholesale Telecommunications Services business segment is comprised of wholesale carrier services provided to other long distance carriers. The Retail Telecommunications Services business segment includes domestic and international prepaid and rechargeable calling cards and consumer long distance services to individuals and businesses. The Winstar business segment operates as a competitive local exchange carrier ("CLEC") using fixed wireless technology to provide local and long distance phone services, and high speed Internet and data communications solutions. The Internet Telephony business segment reflects the results of the Company's formerly majority-owned subsidiary, Net2Phone. The Media business segment operates several media and entertainment-related businesses, most of which are currently in the early stages of development.

The Company evaluates the performance of its business segments based primarily on operating income (loss) after depreciation, amortization and impairment charges, but prior to interest income (expense), other income (expense), income taxes, extraordinary items and cumulative effect of accounting changes. All corporate overhead is allocated to the business segments based on time and usage studies, except for certain specific corporate costs, such as treasury management and investment-related costs, which are not allocated to the business segments. Operating results and other financial data presented for the principal business segments of the Company for the years ended July 31, 2000, 2001 and 2002 are as follows (in thousands):

	Wholesale Telecommunications Services	Retail Telecommunications Services	Winstar(1)	Internet Telephony(2)	Media(3)	Corporate	Total
Year ended July 31,							
2000							
Revenues	\$520,518	\$ 502,512	\$ —	\$ 56,075	\$ 14,807	\$ —	\$1,093,912
Segment loss	(8,409)	(11,477)	—	(125,865)	(39,134)	(31,726)	(216,611)
Depreciation and amortization	17,252	16,656	—	6,804	5,228	2,624	48,564
Total assets	416,045	345,682	—	401,286	11,945	44,097	1,219,055
Year ended July 31,							
2001							
Revenues	388,120	816,384	—	—	26,446	—	1,230,950
Segment loss	(69,454)	(34,118)	—	—	(265,600)	(63,538)	(432,710)
Depreciation and amortization	23,472	26,719	—	—	7,519	2,641	60,351
Total assets	516,395	1,028,069	—	—	269,062	68,063	1,881,589
Year ended July 31,							
2002							
Revenues	308,987	1,121,674	79,604	—	21,349	—	1,531,614
Segment income (loss)	(30,572)	61,396	(96,644)	—	(132,006)	(26,466)	(224,292)
Depreciation and amortization	20,696	33,988	6,691	—	2,253	2,388	66,016
Total assets	\$220,060	\$1,078,195	\$159,726	\$ —	\$ 91,776	\$ 58,163	\$1,607,920

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Revenue from customers located outside of the United States represented approximately 17%, 16% and 18% of total revenues for the years ended July 31, 2000, 2001 and 2002, respectively, with no single foreign geographic area representing more than 10% of total revenues for the year ended July 31, 2000, and Western Europe representing 15% and 17% of total revenues for the years ended July 31, 2001 and 2002, respectively. Revenues are attributed to foreign geographic areas based on the location where the customer is invoiced. Gross and net long-lived assets mainly held in Western Europe totaled approximately \$28.3 million and \$18.7 million, and \$31.9 million and \$28.2 million as of July 31, 2001 and 2002, respectively.

- (1) Since acquisition of Winstar in December 2001.
- (2) Included in loss from operations for the Internet Telephony business segment for the year ended July 31, 2000 was approximately \$41.0 million of non-cash compensation as a result of stock option grants, modifications and accelerations made by Net2Phone. In addition, contributing to the loss from operations was the significant level of sales and marketing expenses, as well as general and administrative expenses, as Net2Phone expanded its distribution relationships, corporate infrastructure and human resources.
- (3) Included in loss from operations for our Media business segment for the years ended July 31, 2001 and 2002 were \$193.4 million and \$110.4 million, respectively, of impairment charges related to the write-down of the undersea fiber asset obtained as part of the TyCom Ltd. ("TyCom") settlement.

Reconciliation To Consolidated Financial Information

A reconciliation of the results for the operating segments to the applicable line items in the consolidated financial statements is as follows (in thousands):

	2000	2001	2002
Segment loss—reportable segments	\$(216,611)	\$ (432,710)	\$(224,292)
Interest income, net	7,231	52,768	21,757
Other income (expense):			
Equity in loss of affiliates	(6,289)	(75,066)	(43,989)
Gain on sales of subsidiary stock	350,344	1,037,726	—
Investment and other income (expense), net	258,218	164,762	(12,117)
Income (loss) before minority interests, income taxes, extraordinary item and cumulative effect of accounting change	392,893	747,480	(258,641)
Minority interests	(59,336)	5,726	22,070
Provision for (benefit from) income taxes	218,403	209,395	(124,345)
Income (loss) before extraordinary item and cumulative effect of accounting change	233,826	532,359	(156,366)
Extraordinary loss on retirement of debt, net of income taxes of \$1,894	(2,976)	—	—
Cumulative effect of accounting change, net of income taxes of \$3,525	—	—	(146,983)
Consolidated net income (loss)—reported	<u>\$ 230,850</u>	<u>\$ 532,359</u>	<u>\$(303,349)</u>

11. Additional Financial Information

Trade accounts payable includes approximately \$112.9 million and \$84.1 million due to telecommunication carriers at July 31, 2001 and 2002, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

12. Acquisitions

CTM Brochure Display, Inc.

On June 30, 2000, the Company acquired a 100% interest in CTM Brochure Display, Inc. ("CTM"), a brochure distribution company, for an aggregate purchase price of approximately \$23.8 million. The purchase price consisted primarily of \$5.1 million in cash, \$16.9 million in notes payable to the former owners and the liquidation of \$1.4 million of CTM's bank debt. In connection with this transaction, the Company recorded goodwill of \$23.0 million and tax liabilities of \$3.0 million. The acquisition was accounted for as a purchase, and accordingly, the net assets and results of operations of the acquired business have been included in the consolidated financial statements from the date of acquisition. During the year ended July 31, 2001, the Company repaid the entire principal balance on the notes payable, together with accrued interest.

Aplio S.A.

On July 7, 2000, Net2Phone acquired all of the outstanding capital stock of Aplio, S.A. ("Aplio"), a company located in France with technology that enables VoIP devices. Consideration consisted of \$2.9 million in cash at closing, 0.6 million shares of Net2Phone's common stock which were valued at \$35.50 per share, issuance of promissory notes aggregating \$6.5 million, \$1.1 million in acquisition related costs and \$4.8 million in cash that was paid within eighteen months of the closing of the transaction.

The aggregate purchase price of \$36.0 million plus the fair value of net liabilities assumed of \$2.7 million was allocated as follows: approximately \$17.5 million to goodwill, \$20.7 million to core technology and patents and \$0.5 million to assembled workforce. The acquisition was accounted for under the purchase method of accounting by Net2Phone, and accordingly, the net assets and results of operations of the acquired business was included in the consolidated financial statements through July 2000.

PT-1 Communications

In February 2001, the Company purchased certain prepaid calling card business assets of PT-1 Communications, Inc. ("PT-1"), a wholly-owned subsidiary of STAR Telecommunications, Inc., with a payment of cash and assumption of certain liabilities, including the obligation to honor the outstanding phone cards of PT-1. The cash payment and assumption of net liabilities incurred were approximately \$26.3 million with substantially all of the purchase price recorded as goodwill.

Equity Interests in Teligent, Inc. and ICG Communications, Inc.

In April 2001, through its IDT Investments, Inc. subsidiary ("IDT Investments"), the Company acquired from Liberty Media (i) a company whose sole asset was 21.4 million shares of Teligent, Inc. ("Teligent") Class A common stock, as well as (ii) an interest in ICG Communications, Inc. ("ICG"), represented by 50,000 shares of ICG's 8% Series A-1 convertible preferred stock and warrants to purchase approximately 6.7 million shares of ICG's common stock. In exchange, IDT Investments issued Liberty Media a total of 10,000 shares of its Class B common stock and 40,000 shares of its Series A convertible preferred stock. Upon completing the transaction, IDT effectively owned approximately 32% of the equity of Teligent, and approximately 29% of the equity of ICG. The total consideration for Teligent and ICG's April 2001 transaction was approximately \$10.3 and \$3.4 million, respectively.

In May 2001, through its IDT Investments subsidiary, the Company entered into an agreement with various affiliates of HMTF to increase IDT's strategic investments in Teligent and ICG. Under the terms of the

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

agreement, the HMTF affiliates received 18,195 shares of IDT Investments' Series B convertible preferred stock in exchange for the HMTF affiliates' stakes in Teligent and ICG. The HMTF affiliates owned 219,998 shares of Teligent's Series A 7¾% convertible preferred stock, 23,000 shares of ICG's 8% Series A-2 convertible preferred stock and warrants to purchase approximately 3.1 million shares of ICG's common stock. Upon completing the transaction, IDT effectively owned approximately 37% of the equity of Teligent, and approximately 42% of the equity of ICG. The total consideration for Teligent and ICG's May 2001 transaction was approximately \$2.0 and \$1.6 million, respectively.

The pro-rata share of the losses of Teligent and ICG recorded by IDT subsequent to these acquisitions have fully eliminated the carrying value of the Company's investment in these companies.

In May 2001, Teligent filed a voluntary bankruptcy petition under Chapter 11 of the U.S. Bankruptcy Code. ICG had previously filed for bankruptcy protection in November 2000.

Winstar

On December 19, 2001, the Company, through a subsidiary, acquired the core domestic telecommunications assets of Winstar Communications, Inc. and certain of its subsidiaries that are debtors and debtors in possession in bankruptcy proceedings pending before the United States Bankruptcy Court for the District of Delaware. The acquiring subsidiary was subsequently renamed Winstar Holdings, LLC. Winstar operates as a CLEC using fixed wireless technology to provide local and long distance phone services, and high speed Internet and data communications solutions.

The purchase price for the Winstar assets was comprised of a \$30.0 million cash payment, \$12.5 million in newly issued shares of IDT Class B common stock and 5% of the common equity interests in the acquiring subsidiary (the remaining 95% of the common equity interests as well as all of the preferred equity interests in the acquiring subsidiary were owned by IDT). The Company also agreed to invest \$60.0 million into Winstar to be used as working capital. The acquisition has been accounted for under the purchase method of accounting. The results of operations of Winstar have been included in the Company's consolidated statements of operations since the date of acquisition. The preliminary allocation of the purchase price, pending final determination of certain acquired balances, is as follows (in thousands):

Trade accounts receivable and other current assets	\$ 51,301
Property, plant, equipment and intangible assets	37,923
Trade accounts payable, accrued expenses and other current liabilities	(44,487)
Minority interest	(2,237)
Value of assets acquired	<u>\$ 42,500</u>

The fair value of the Winstar assets acquired and liabilities assumed would have exceeded IDT's acquisition cost. Therefore, in accordance with SFAS No. 141, Business Combinations, the excess value over the acquisition cost has been allocated as a pro rata reduction of the amounts that otherwise would have been assigned to the acquired assets, except with respect to the following:

- *Trade accounts receivable*—present values of amounts to be received, less allowances for uncollectibility and collection costs.
- *Other current assets* (principally assets to be sold)—fair value less cost to sell.
- *Trade accounts payable, accrued expenses and other current liabilities* (principally relating to contractual agreements assumed)—present values of amounts to be paid.

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On April 16, 2002, IDT, through a subsidiary, purchased the 5% of common equity interests in Winstar that it did not own. Consideration consisted of 0.8 million shares of IDT Class B common stock, which were valued at \$13.3 million.

The following pro forma financial information presents the combined results of operations of IDT and Winstar, as if the Winstar acquisition had occurred as of the beginning of the periods presented, after giving effect to certain adjustments, including depreciation expense, income taxes and the issuance of IDT Class B common stock as part of the purchase price. The pro forma financial information does not necessarily reflect the results of operations that would have occurred had IDT and Winstar been a single entity during such periods.

	Year Ended July 31,		
	2000	2001	2002
	(in thousands, except per share data)		
Revenues	\$1,325,821	\$ 1,451,912	\$1,604,314
Income (loss) before cumulative effect of accounting change	\$ 108,472	\$(1,421,850)	\$ (205,083)
Net income (loss)	\$ 108,472	\$(1,421,850)	\$ (352,066)
Earnings per share:			
Income (loss) before cumulative effect of accounting change			
Basic	\$ 1.51	\$ (20.29)	\$ (2.70)
Diluted	\$ 1.41	\$ (18.57)	\$ (2.70)
Net income (loss)			
Basic	\$ 1.51	\$ (20.29)	\$ (4.63)
Diluted	\$ 1.41	\$ (18.57)	\$ (4.63)

13. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Year ended July 31		
	2000	2001	2002
	(in thousands, except per share data)		
Numerator:			
Net income (loss)	<u>\$230,850</u>	<u>\$532,359</u>	<u>\$(303,349)</u>
Denominator:			
Weighted-average number of shares used in calculation of earnings per share—Basic	69,933	68,301	75,108
Effect of stock options	<u>5,306</u>	<u>6,485</u>	<u>—</u>
Weighted-average number of shares used in calculation of earnings per share—Diluted	<u>75,239</u>	<u>74,786</u>	<u>75,108</u>
Earnings per share—Basic	\$ 3.30	\$ 7.79	\$ (4.04)
Earnings per share—Diluted	\$ 3.07	\$ 7.12	\$ (4.04)

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following securities have been excluded from the dilutive per share computation as they are antidilutive:

	Year ended July 31		
	2000	2001	2002
	(in thousands)		
Stock options	449	1,163	5,291
Contingently issuable shares	—	—	369
Total	<u>449</u>	<u>1,163</u>	<u>5,660</u>

14. Net2Phone Subsidiary Stock Sales

During the years ended July 31, 2000 and 2001, the Company recognized approximately \$350.3 and \$1,037.7 million, respectively, in gains on sales of subsidiary stock related to Net2Phone stock sales, as follows:

On August 3, 1999, Net2Phone completed an initial public offering of 6.2 million shares of its common stock at an initial public offering price of \$15.00 per share, resulting in net proceeds of \$85.3 million. Upon completion of the initial public offering, 3.1 million shares of Net2Phone Series A preferred stock were converted into 9.4 million shares of Net2Phone Class A common stock. As a result of the initial public offering and concurrent conversion of Series A preferred stock to Class A common stock, the Company's ownership percentage in Net2Phone decreased from 90.0% to 56.2%. In connection with such offering, the Company recorded a gain of \$65.5 million.

In December 1999, Net2Phone completed a secondary offering of 3.4 million shares of common stock at a price of \$55.00 per share. In connection with this offering, IDT also sold 2.2 million shares of Net2Phone common stock at \$55.00 per share. Total proceeds to the Company, after deducting underwriting discounts, commissions and offering expenses were \$292.8 million. The Company's ownership interest in Net2Phone before and after these transactions decreased from 56.2% to 45.0%. The Company recorded gains on sales of stock of \$182.6 million in connection with these offerings.

In March 2000, the Company acquired 0.8 million shares of Yahoo! Inc. in exchange for 2.8 million shares of Net2Phone common stock at a then equivalent market value of approximately \$150.0 million. In connection with this transaction, the Company recorded a gain on sale of subsidiary stock of \$102.2 million.

In August 2001, IDT sold 14.9 million shares of Net2Phone common stock at \$75.00 per share. Net proceeds to the Company as a result of this sale were \$1,042.1 million. The Company's ownership interest in Net2Phone before and after this transaction decreased from 45.0% to 16%. The Company recorded a total gain of \$1,037.7 million in conjunction with this transaction.

15. TyCom Ltd. Settlement

On October 10, 2000, IDT reached a full and final settlement with TyCom of all pending claims brought against one another and their respective affiliates. The settlement agreement is subject to a confidentiality agreement among the parties and only the following disclosure by IDT is permitted under the terms of that agreement.

Under the terms of the settlement, TyCom granted to IDT Europe B.V.B.A. ("IDT Europe"), free of charge, certain exclusive rights to use capacity on the transatlantic and transpacific segments of TyCom's global

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

undersea fiber optic network (the "TyCom Global Network"), which TyCom is deploying. The settlement agreement provides for IDT Europe to obtain exclusive indefeasible rights to use (IRU) two 10 Gb/s wavelengths on the transatlantic segment (which we have been informed has been deployed) and two 10 Gb/s wavelengths on the transpacific segment (which we believe is still under development) for fifteen years from the applicable Handover Dates.

Operation, administration and maintenance for the wavelengths used by the Company will be provided by TyCom for a fifteen year period after the relevant Handover Date, free of charge. TyCom has also granted the Company certain rights to resell any unused capacity on the wavelengths through TyCom as its sole and exclusive agent. In addition, the Company will also have the option, exercisable at least annually, to convert the available capacity on its wavelengths to available equivalent capacity on another portion of the TyCom Global Network. In recognition of the settlement, a gain of \$313.5 million was included as a component of "investment and other income." The Company subsequently re-evaluated the recoverability of the carrying value of its IRU in accordance with SFAS No. 121 and, as a result, the Company has recorded an impairment loss of \$193.4 million and \$110.4 million for the years ended July 31, 2001 and 2002, respectively, to write down the asset to its fair value.

16. Comprehensive Income (Loss)

The accumulated balances for each classification of comprehensive income (loss) consists of the following (in thousands):

	Unrealized gain (loss) in available-for- sale securities	Foreign currency translation	Accumulated other comprehensive loss
Beginning balance at July 31, 1999	\$ —	\$ —	\$ —
Change during period	(94,044)	1,391	(92,653)
Balance at July 31, 2000	(94,044)	1,391	(92,653)
Change during the period	89,148	930	90,078
Balance at July 31, 2001	(4,896)	2,321	(2,575)
Change during the period	(1,064)	964	(100)
Balance at July 31, 2002	<u>\$ (5,960)</u>	<u>\$3,285</u>	<u>\$ (2,675)</u>

17. Price Guarantee of Class B Common Stock

In March 2001, the Company exercised an option to sell to AT&T approximately 2.0 million shares of its Class B common stock for approximately \$74.8 million. In conjunction with the formation of the consortium, IDT guaranteed to AT&T the value of approximately 1.4 million shares of IDT Class B common stock still being retained by AT&T. If the value of IDT Class B common stock is less than \$27.5 million on October 19, 2002, and AT&T or an affiliate retains all the shares through such date, then IDT will be obligated to pay AT&T the difference with cash, additional shares of IDT Class B common stock or a combination of both, at the option of IDT. In connection with this obligation, the Company recorded in "investment and other income (expense)" a

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

charge of \$5.3 million during the year ended July 31, 2002. The Company was subject to additional charges of \$1.0 million through October 19, 2002 based on changes in the market value of IDT Class B common stock. As a result, the Company's total liability is \$6.3 million as of October 19, 2002.

18. Extraordinary Loss

On May 10, 1999, the Company obtained a Senior Secured Credit Facility from a consortium of financial institutions. During the second quarter ended January 31, 2000, the Company repaid all of the outstanding principal balance together with accrued interest. The Company recorded a pre-tax extraordinary loss of \$4.9 million in connection with the repayment during the year ended July 31, 2000.

19. Selected Quarterly Financial Data (unaudited)

The table below presents selected quarterly financial data (unaudited) of the Company for the calendar quarters in the fiscal years ended July 31, 2002 and 2001:

Quarter Ended	Revenues	Loss from Operations	Income (loss) before cumulative effect of accounting change			
			Amount	Per Share —Basic	Per Share —Diluted	Net Income (Loss)
			(in thousands, except for per share data)			
2002:						
October 31 /a/	\$ 339,209	\$ (12,565)	\$ (11,332)	\$ (0.16)	\$ (0.16)	\$(158,315)
January 31	374,025	(27,774)	(17,212)	(0.23)	(0.23)	(17,212)
April 30	401,653	(42,829)	(49,593)	(0.64)	(0.64)	(49,593)
July 31 /b/	416,727	(141,124)	(78,229)	(0.99)	(0.99)	(78,229)
Total	<u>\$1,531,614</u>	<u>\$(224,292)</u>	<u>\$(156,366)</u>			<u>\$(303,349)</u>
2001:						
October 31 /c/	\$ 276,597	\$ (60,070)	\$ 869,568	\$12.43	\$11.27	\$ 869,568
January 31	287,597	(48,455)	(117,104)	(1.77)	(1.77)	(117,104)
April 30 /d/	335,722	(55,571)	(48,277)	(0.73)	(0.73)	(48,277)
July 31 /e/	331,034	(268,614)	(171,828)	(2.44)	(2.44)	(171,828)
Total	<u>\$1,230,950</u>	<u>\$(432,710)</u>	<u>\$ 532,359</u>			<u>\$ 532,359</u>

/a/ Included in net loss is a \$147.0 million cumulative effect of accounting change, net of \$3.5 million of income taxes, due to the adoption of SFAS No. 142.

/b/ Included in loss from operations was \$110.4 million of impairment charges related to the IRU received as part of the Tycom settlement.

/c/ Included in net income is \$1,037.7 million in gains on sales of subsidiary stock related to Net2Phone stock sales.

/d/ Included in loss from operations was \$193.4 million of impairment charges related to the IRU received as part of the Tycom settlement.

IDT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

20. Subsequent Events

In August 2002, Net2Phone and its Adir subsidiary consummated the settlement of their lawsuit filed on March 19, 2002 in the United States District Court for the District of New Jersey against Cisco Systems ("Cisco") and a Cisco executive who had been a member of the Adir board of directors. The suit arose out of the relationships that had been created in connection with Cisco's and Net2Phone's original investments in Adir and out of Adir's subsequent purchase of NetSpeak, Inc. in August 2001. The parties settled the suit and all related claims against Cisco and the Cisco executive in exchange for (i) the transfer, during the first quarter of fiscal 2003, to Net2Phone of Cisco's and Softbank Asia Infrastructure Fund's respective 11.5% and 7.0% interests in Adir and, (ii) the payment by Cisco, during such quarter, of \$19.5 million to Net2Phone and Adir. As a result of this settlement, Net2Phone will recognize, for the quarter ended October 31, 2002, a gain of approximately \$58.4 million. Net2Phone will be consolidated by IDT in Fiscal year 2003, which began on August 1, 2002.

IDT CORPORATION
FINANCIAL STATEMENT SCHEDULE—VALUATION AND QUALIFYING ACCOUNTS

	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Deductions (1)</u>	<u>Balance at End of Period</u>
	(Dollars, in thousands)			
2000				
Reserves deducted from accounts receivable:				
Allowance for doubtful accounts	\$ 7,643	\$20,154	\$ (1,026)	\$26,771
2001				
Reserves deducted from accounts receivable:				
Allowance for doubtful accounts	\$26,771	\$32,873	\$(37,136)	\$22,508
2002				
Reserves deducted from accounts receivable:				
Allowance for doubtful accounts	\$22,508	\$19,203	\$ (2,818)	\$38,893

(1) Uncollectible accounts written off, net of recoveries.